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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF COMMUNITY WATER OF GREEN VALLEY FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PROPERTY AND FOR AN INCREASE IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICES	DOCKET NO. W-02304A-08-0590

REPLY POST-HEARING BRIEF
OF COMMUNITY WATER COMPANY OF GREEN VALLEY

DECEMBER 8, 2009

Arizona Corporation Commission
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I. INTRODUCTION.

The Company will not use this Reply Brief to repeat every point it made in its Initial Post-Hearing Brief. Rather, the Company will focus on rebutting specific arguments Staff raises in its Closing Brief filed November 24, 2009.[1] While Staff and the Company agree on several issues and adjustments, there are still a few key areas where consensus was not reached. Most troubling is Staff's apparent reliance on a cash flow analysis that does not appear in the evidentiary record. Further, Staff used its rate base and operating income adjustments to justify its recommendation to increase revenue by $790,531. The Company recommends a $830,315 increase in revenue.

In short, the Company believes it has met its burden of showing that (1) contributions in aid of construction ("CIAC") related to construction work in progress ("CWIP") should not be included in the rate base determination; (2) the Company's rate design better balances the important goals of revenue stability, gradualism, affordability and conservation; (3) monthly minimum charges for construction based on meter size is appropriate; (4) the Company's proposed increases to miscellaneous charges reflect actual costs of providing call outs and other services; (5) interest rates on customer deposits should be adjusted to reflect a more realistic rate going forward. CWCGV requests full relief as reflected in its pre-filed testimony and final schedules submitted as part of its Rejoinder Filing.

Notably, the Company made adjustments from its original application in this case to arrive at its final recommendations contained in its Rejoinder Filing.[2] This includes a Fair Value Rate Base of $7,504,829, a Required Operating Margin of $573,579 and an Operating Income Deficiency of $803,315. Staff's Final Schedule PMC-1 contains figures that are from the Company's original filing back on December 9, 2008. Since that time, the Company accepted many of Staff's adjustments and made additional adjustments on its own.

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[1] This reply brief also corrects a couple of typographical errors from its Initial Post-Hearing Brief: (1) at page 5, line 6 ("790,351" instead of "790,931"); and (2) page 13, line 12 ("$3,825,058" instead of "$3,805,258").

[2] *See* Rejoinder Testimony of Thomas J. Bourassa (Admitted as Exhibit A-7) at Rejoinder Schedule A-1.

The Company recommends an increase in the revenue requirement of $803,315 (26.58%) versus Staff's recommendation of an increase of $790,531 (26.27%). The Parties are close, but are not quite to the proverbial cigar.

II. ANY REVENUE REQUIREMENT DETERMINATION MUST BE BASED ON THE EVIDENCE IN THE RECORD, RATHER THAN AN ALLUSION TO A CASH FLOW ANALYSIS NOT IN THE RECORD.

Staff states in its Closing Brief that it arrived at its revenue requirement through a cash flow analysis[3]. This is a puzzling argument, given the evidence on the record. While Mr. Chavez stated that Staff relied on a "cash flow analysis" during the evidentiary hearing, Mr. Chavez made no reference to a formal cash flow analysis in his pre-filed testimony. In fact, Mr. Chavez's pre-filed testimony discuss adjustments to rate base and operating income, but does not appear to contain any reference to the cash flow analysis he alluded to at the evidentiary hearing. The only possible reference is when Staff determined that a 15.00 operating margin provides sufficient revenues to service long-term debt, on-going expenses and capital requirements. Even so, Staff's operating income and recommended increase in operating revenue in its Final Schedule PMC-1 derive directly from Staff Final Schedules PMC-2 and PMC-6. These schedules are entitled "RATE BASE – ORIGINAL COST" and "RECLASSIFICATION OF PLANT" respectively. In addition, Staff's Required Operating Income figure in PMC-1 - $569,764 – equals its Operating Income figure from its final schedule entitled "OPERATING INCOME – TEST YEAR AND STAFF RECOMMENDED"[4]. While the Company does not deny that Staff considered cash flow in making its recommendations, Staff's testimony and the evidence focuses on adjustments it made to rate base and operating income. The Commission should consider that evidence and testimony when making its determination as to what is the appropriate revenue requirement. This includes the treatment of contributions in aid of construction ("CIAC") related to CWIP, which Staff spent a significant amount of its pre-filed testimony on.

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[3] *See* Staff's Closing Brief ("Staff Brief") at 2.
[4] *See* Final Schedule PMC-7, Column [E], Line 25.

III. CIAC RELATED TO CWIP SHOULD NOT BE INCLUDED IN RATE BASE.

A. Funds Or Plant Obtained Through Contributions Are Not Simply Available For Any Purpose.

Staff first argues that CIAC related to CWIP should be included in the rate base calculation because "the Company has use of funds or plant contributed by others, regardless of how the funds, or plant, are used."[5] This is another puzzling argument. Staff implies that the Company can simply use funds or plant for whatever purpose it pleases; in reality, the Company has no such discretion. In fact, for a water utility, CIAC is defined as "[f]unds provided to the utility by [a person requesting the utility to supply water service] under the terms of a main extension agreement and/or service connection tariff the value of which are not refundable."[6] A main extension is "[t]he mains and ancillary equipment necessary to extend the existing water distribution system to provide service to additional customers."[7] Given that main extension agreements must be approved by Staff,[8] it is not the case that these funds are available for any purpose. Therefore, that should not be a compelling reason to include CIAC related to CWIP in the rate base calculation.

B. Contributions Related To Construction Work In Progress Are No Different Than Contributions Related To Other Plant Not Used And Useful.

Next, Staff argues that CWCGV has "oversimplified the treatment of CIAC in this case" and that treatment of CIAC related to CWIP is somehow different that CIAC related to Plant Held For Future Use ("PHFFU") or plant determined to be excess capacity.[9] Staff argues that there has been a determination to disallow PHFFU or excess capacity, as opposed to CWIP. Staff ignores the fact that in *all* of those cases, plant is not used and useful.[10] Further, PHFFU or plant

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[5] Staff Brief at 4.
[6] A.A.C. R14-2-401.8.
[7] A.A.C. R14-2-401.14.
[8] A.A.C. R14-2-406.M.
[9] Staff Brief at 4-5.
[10] Tr. at 107.

determined to be excess capacity can be included in rate base *after* a subsequent rate case, just like CWIP.

> **Q. Mr. Bourassa, can plant that is not deemed to be used and useful in a present rate case be deemed to be used and useful in a future rate case?**
>
> A. It can.
>
> **Q. And that includes plant held in future use, if it's not deemed to be part of the rate base calculation in current rate base, it can become part of the calculation in a future rate base if deemed used and useful?**
>
> A. Yes.
>
> **Q. And the same goes for plant that is deemed excess capacity?**
>
> A. Yes.
>
> **Q. And the same goes for plant that is – or costs related to plant that is under construction or construction work in progress?**
>
> A. Correct.[11]

In contrast to Staff's implication, the Company did not acknowledge that there is any real difference between CIAC related to CWIP and CIAC related to PHFFU or excess capacity. Removing CIAC related to plant not used and useful (as Staff properly proposed in both recent rate cases for Johnson Utilities and Far West Water & Sewer Company) is the proper adjustment to make. Staff's distinction is without a difference – CIAC related to not used and useful plant (no matter the reason) is removed from rate base in order to prevent a mismatch.[12] In short, the mismatch occurs when CIAC related to plant not used and useful is included, whether it is completed plant or not.[13]

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[11] Tr. at 130.
[12] Tr. at 108, 110-11.
[13] Tr. at 106-107; 126-27.

C. The Mismatch Created By Staff's Adjustment Is A Real And Permanent Impact And Is Not Simply A Timing Issue As Staff Suggests.

Staff seemingly downplays the mismatch; it believes this is simply a timing issue.[14] The Company strongly disagrees. As Mr. Bourassa stated at the evidentiary hearing, the mismatch still exists even if plant is ultimately included in rate base after a subsequent rate case.

> **Q. Okay. And on the issue of the mismatch, would you agree that if there hasn't been a determination as to whether the CWIP, once completed, will go into rate base or not, then it would be more of a timing issue than a mismatch issue because in the next rate case that CWIP would become plant, the Company would seek to include it, correct, hypothetically speaking?**
>
> A. I disagree. It is a mismatch. It's not a – it's the result of a timing perhaps, but it will result in a mismatch by including, one, the CIAC in rate base, and the other, the plant that is being funded by it.
>
> . . .
>
> **Q. But is it a mismatch that will ultimately be corrected with the passages of time?**
>
> A. In the next rate case when both are recognized in rate base, if that is what you mean by corrected, yes.
>
> In the meantime, if we include CIAC in rate base, artificially reducing operating expenses, the Company will put that plant into service and will be out that deprecation expense from now until the next rate case. And in the meantime, if that plant is accepted in the next rate case, it will come in at its depreciated value. It won't come in at the cost at full value; it will come in as depreciated value, so the Company will not have recovered the depreciation on that plant.[15]

To state that the issue is merely one of timing, in other words, ignores the fact that the Company will not recover depreciation expense between the time CIAC related to CWIP is in rate base to when the plant associated with that CIAC is included in rate base – which is *after* the next rate case. This is true, even though depreciation is a non-cash item. As stated before, the Company feels a real and significant impact if CIAC related to CWIP is included in the rate base calculation. For CWCGV, this is not a mere timing issue.

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[14] Staff Brief at 5.

[15] Tr. at 108-09.

D. Unless Staff is now endorsing the inclusion of CWIP in rate base, the issue of including contributions related to CWIP still exists.

Finally, Staff argues that "the Company acknowledged that if the Company filed a rate case today, the issue regarding CWIP and associated CIAC would not be an issue"[16] It is true that the $537,531 at issue would not be an issue if the Company filed a rate case in October 2009 – because the plant associated with that amount is now in service (as opposed to being under construction).[17] At the same time, what was CWIP during the test year is now plant in service and the costs of that plant would also be included in rate base.[18] The Company did not request any CWIP in this case and the issue remains (unless Staff is now recommending including the associated CWIP in rate base). Rather than supporting Staff's treatment, the argument actually supports including both CWIP, as well as CIAC related to CWIP, in rate base for any plant completed and in service (for an amount is likely to be much larger than the $537,531 in question here.)[19] The Company is not requesting that, however. The Company merely requests that CIAC related to CWIP not be included so that no mismatch occurs.

E. CIAC Related To CWIP Should Not Be Included In Rate Base.

The bottom line is still that CIAC related to CWIP is for *future* plant, but Staff deducts it from net plant in service at *present*. Staff's adjustment does not allow any return on $537,531 that funded plant presently in service that was provided by CWCGV "investors" (*i.e.*, the Company's member-customers). This understates earnings and negatively impacts the Company's cash flow and its revenue requirement. The Company remains opposed to Staff's inclusion of CIAC related to CWIP in rate base for all of the reasons stated and shown as part of the evidentiary record and as summarized in its Initial Post-Hearing Brief.[20]

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[16] Staff Brief at 5.
[17] Tr. at 124.
[18] Tr. at 123-24.
[19] Id.
[20] The Company notes that, in recent rate cases before the Commission (including H2O, Inc. in Docket No. W-02234A-07-0557) the question of whether contributed plant or funds is CIAC if it is not related to plant in service – under NARUC Uniform System of Accounts for Class A Water Utilities System: 271. Contributions in Aid of Construction (1996). The Company did not raise this argument directly in this case. Even so, the Company's

IV. ACCUMULATED DEPRECIATION.

Regarding accumulated depreciation, Staff made additional adjustments not revealed until it filed its Closing Brief (which is why the Company waited until now to address the issue.)[21] The difference between Staff's amount of $7,099,063 and the Company's amount of $7,123,193 is now even narrower than before. The Company understands this changed Staff's FVRB figure $6,991,408. Still, there is a slight difference between the two figures. The Company maintains its amount of accumulated depreciation as proper for the reasons Mr. Bourassa has provided in his pre-filed testimony.[22]

V. THE COMPANY BELIEVES ITS PROPOSED RATE DESIGN BEST BALANCES FACTORS INCLUDING REVENUE STABILITY AND GRADUALISM – AS WELL AS AFFORDABILITY AND THE NEED TO PROMOTE CONSERVATION.

The Company believes its rate design better balances all of the competing factors that should be taken into account. The Company proposes a inverted-block rate design with three tiers for residential customers and two tiers for non-residential customers – and uses the same break over points Staff recommended and the Commission adopted in CWCGV's last rate case – Decision 69205 (December 21, 2006). Still, Staff states that "rate design is not static in nature" and that it continues to evolve "based on the circumstances that exist in each case to achieve the goal of promoting the efficient use of water while allowing the Company the opportunity to earn its revenue requirement."[23] Even so, Staff admits that the Company's rate design proposal also promotes an efficient use of water.[24] This is without needing to change break over points for any customers.

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argument does relate to the matching problem caused by including contributed plant or funds related to CWIP in the rate base determination that the NARUC definition presumed to avoid.

[21] Staff did provide notice that it would be making such adjustment at the evidentiary hearing. Consequently, the Company is not disputing Staff making its adjustment at this time. The Company, however, still maintains its recommendation.

[22] *See* Bourassa Rejoinder at 5 (specifically regarding 2006 depreciation expense for transportation equipment)

[23] Staff Brief at 8.

[24] Tr. at 174.

A. **<u>The Company's Rate Design Shifts The Burden Of Recovery From Residential Customers More Gradually Than Staff's Rate Design</u>.**

One of the problems with Staff's proposed rate design, as the Company sees it, is that it shifts too much of the burden onto commercial and larger-metered customers.[25] Staff's rate design proposal shits two percent more of the burden onto commercial customers. The Company's rate design proposal also shifts revenue recovery onto commercial customers – but more gradually (0.5 percent is shifted onto commercial customers, for example.)[26] Staff admits that more of the burden of revenue recovery is put onto commercial customers with its rate design.[27] So, while both rate design proposals promote the efficient use of water and ease the burden on residential customers, the Company's design is a more gradual shift. These comparisons, which Staff did not dispute, also counter Staff's argument that the Company is shifting recovery onto 5/8-inch residential customers.[28]

B. **<u>The Company's Rate Design Also Better Balances Revenue Stability With Affordability And Conservation</u>.**

Staff is correct that the Company proposes a higher monthly minimum and first tier for residential customers. But the Company's final proposed charges are not as Staff indicates in its Closing Brief. The differences between the Company and Staff for 5/8-inch and ¾-inch residential customers are as follows:

	Company[29]	Staff[30]
Monthly Minimum	$13.21	$13.00
0 to 3,000 gallons	$1.54	$1.30
3,001 to 10,000 gallons	$2.45	$2.50
Over 10,000 gallons	$3.00	$3.42

Mr. Bourassa explains that the need for revenue stability must be balanced with other important rate design factors such as conservation, affordability and gradualism.[31] The Company's design still increases the price signal between the first and second tiers to $0.91 per 1,000 gallons

[25] *See* Rebuttal Testimony of Thomas J. Bourassa (Admitted as Exhibit A-6) at 13.
[26] Id. at 13-14.
[27] Tr. at 177-78.
[28] Staff Brief at 9.
[29] *See* Rejoinder Testimony of Thomas J. Bourassa (Admitted at Exhibit A-7) at 8, Rejoinder Schedule H-3.
[30] Final Schedule PMC-14.
[31] Tr. at 119.

from $0.57 per 1,000 gallons.[32] The Company's proposed rate design would result in a $4.28 monthly increase for the average customer, versus a $3.44 increase under Staff's proposed rate design (a difference of about $0.84 per month.)[33] While the Company's rate design results in a greater impact on lower-use residential customers, that impact is relatively modest compared to the impact Staff's rate design proposal would have on commercial customers within CWCGV's service territory.

Staff also argues that it modified the break over points to prevent one class from subsidizing the other.[34] But in response to questions from Administrative Law Judge Martin, Staff admits that the higher-use commercial customers subsidize the lower-use residential customers at a higher rate.[35] Despite Staff's desire to avoid what it calls "crossover points", there is no evidence to indicate that the Company's proposal would lead to the type of subsidization Staff wants avoided.

The Company believes it has struck the right balance with its rate design proposal. While it understands that rate design is not incessantly static, changing break over points does not seem fruitful only three years after the last rate case. Further, the Company believes Staff's rate design is too much of a shift onto commercial customers – most of whom are retail outlets and small business customers.[36] For all of the factors provided in testimony and stated previously, the Company believes the Commission should approve its rate design proposal.

VI. THE COMPANY MAINTAINS ITS POSITION THAT CONSTRUCTION CUSTOMERS SHOULD BE CHARGED A MONTHLY MINIMUM BASED ON METER SIZE.

A. The Company Always Intended To Make Construction Customers Whole For Past Overcharges.

Before proceeding to the issue of whether construction customers should be charged going forward – one thing should be made clear. Staff appears to accuse the Company of wanting to

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[32] Bourassa Rebuttal at 13.
[33] Compare Bourassa Rebuttal at 16 to Final Schedule PMC-15.
[34] Staff Brief at 8.
[35] Tr. at 187-88.
[36] Tr. at 26-27.

keep revenues collected for the incorrect charges it assessed against construction customers.[37] This is inaccurate. It was never the Company's intent to simply pocket revenues it did not have the right to retain. Mr. Gabaldón provided pre-filed Rebuttal Testimony clearly indicating its willingness to work with Staff – but seeking to avoid providing refunds if possible.

> **Q. What is the Company proposed plan of action for this issue?**
>
> A. The Company proposes to work with Staff to determine the most efficient way to determine how to resolve the issue. Further, the Company will verify the amount of overcharge in its Rejoinder Testimony. Even so, the Company is proposing that going forward it be authorized to charge a monthly minimum charge for construction customers. Mr. Thomas J. Bourassa testifies as to why the Staff's revenue adjustment for construction water in future rates is not appropriate. In the meantime, the Company has corrected its current tariff to reflect the correct tariff charge. The Company would like to not refund this overcharge.[38]

The Company's intent was clearly to find a way to reimburse construction customers. After Staff provided Surrebuttal Testimony maintain its stance that the Company should refund customers – the Company agreed in its Rejoinder Filing to do so.[39] Quite frankly, the Company came to the realization that there was not a more efficient way to resolve the issue. But the hesitation over refunds was never an outright objection and it certainly was not an opposition to finding some means to credit these customers. In fact, the Company worked diligently to determine the exact amount of overcharge (approximately $22,500), the amount of overcharge per customer, and accepted Staff's recommendations regarding how the issue should be communicated to these customers. It is simply unfair to imply that the Company did not intend to address the error that it made in charging construction customers a monthly minimum from when current rates were in effect.

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[37] Staff Brief at 6.

[38] Rebuttal Testimony of Arturo R. Gabaldón (Admitted as Exhibit A-3) at 5.

[39] Rejoinder Testimony of Arturo R. Gabaldón (Admitted as Exhibit A-4) at 1.

B. Charging Construction Customers Monthly Minimums Is Reasonable And Appropriate.

Going forward, CWCGV believes that construction customers should not be excused from paying monthly minimum charges based on meter size. Simply put, construction customers at zero usage would not pay any fixed costs associated with CWCGV serving them.[40] The fact that the commodity charge is at the highest rate for all levels of usage will not help the Company recover costs if construction customers do not use any water. If construction customers do not pay these costs, other customer classes will absorb those costs. In addition, the Company is concerned that construction customers will not return meters.[41] While Staff argues that the deposit would serve as an incentive for these customers to return meters, the Company believes the generous six-percent interest on customer deposits Staff continues to endorse will offset whatever incentive there is to return those meters.[42]

Staff's opposition appears to be that (1) there is no evidence of the Company actually incurring these burdens; and (2) it failed to provide a statistical analysis that this would become a problem in the future.[43] It is true the Company is not actually experiencing a problem at this time, and that it is not currently requiring a deposit from these customers. This does not eliminate the Company's concern going forward.

In recommending monthly minimum charges for construction customers, the Company is seeking to prevent a problem before it has the potential to manifest. Mr. Gabaldón testified during the evidentiary hearing about the potential for growth and establishing the "right rates" and how there were instances of such customers "not really using the meters with consumption so [the Company] could put them into a proper place."[44] That may have been a small issue in the past, but the Company is concerned about the impacts going forward, especially if CWCGV experiences growth again within its service territory. While Staff indicates that the evidence the Company

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[40] Tr. at 41.
[41] Gabaldón Rebuttal at 6-7.
[42] Gabaldón Rejoinder at 2.
[43] Staff Brief at 9-11.
[44] Tr. at 50-51.

provides is anecdotal, that alone does not render it invalid or not credible. The Company believes that good and sound reasons exist to justify a minimum monthly charge for construction customers based on meter size – as provided on the record through Mr. Gabaldón's testimony – based on his extensive experience at CWCGV.[45]

VII. DEPOSIT INTEREST OF SIX PERCENT DOES NOT REFLECT THE ACTUAL INTEREST THE COMPANY RECEIVES FOR DEPOSITS.

Staff argues that the Company has not demonstrated that the six-percent interest rate has been burdensome – apparently because the Company has not currently collected deposits from customers.[46] Apparently, Staff believes the actual rates currently provided by banks on certificates of deposit and money markets is not sufficient enough evidence.[47] Staff does not dispute that the actual rate on such instruments is more in the neighborhood of two percent; in fact Staff admits there is no indication rates will jump to six percent.[48] The Company should not need to show that the current rate is burdensome, whether the interest expense is "material", or whether and how the Company collects deposits. Rather, the question is whether the interest rate is an accurate reflection of what the Company would actually accrue for such deposits. The Company believes two percent reflects what the Company actually receives for holding the deposits – based on Mr. Bourassa's undisputed testimony to this issue.[49]

VIII. MISCELLANEOUS CHARGES SHOULD REFLECT THE ACTUAL COST OF PROVIDING SERVICES.

The Company acknowledges that it is asking for significant increases in miscellaneous charges – particularly call out charges and reconnection fees. The Company is doing so, however, because it reflects the actual cost to perform such services for its customers. Further, those charges compare favorably with the alternative customers would have (*i.e.*, customers calling a plumber to

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[45] Tr. at 72-73.
[46] Staff Brief at 11-12.
[47] Bourassa Rebuttal at 16.
[48] Tr. at 181.
[49] Bourassa Rebuttal at 16-17.

perform the service.)[50] Perhaps one can take issue with the policy decision to keep a straight-line two-hour minimum. In fact, Staff appears to be more concerned with the lack of statistics regarding the actual length of the typical call out to support the two-hour minimum.[51] Even so, the Company has shown that $35 is the hourly average of service-employee-eligible charges, which includes FICA and Medicare taxes, and transportation costs[52]. To believe that the actual costs to provide call out services has remained at $10 and $20 is unrealistic in CWCGV's service territory. In fact, Mr. Chavez for Staff testified he believed that other utilities are allowed to charge "more than $20."[53] At the least, the Commission should approve Call Out Charge/After-Hours/Saturdays of $35 and a Call Out Charge/Sundays/Holidays of $70 (to reflect double-time). In this way, the cost causer incurs at least a good portion of the actual cost to provide the service requested.

IX. CONCLUSION.

In keeping with its mission – CWCGV strives to maintain and improve service to its member-customers. The Company has clearly shown this commitment – as well as its desire to promote conservation and efficient use of water. But, as it has stated throughout this case, the Company must be able to meet its operating costs – including funding necessary infrastructure and increasing operation and maintenance expenses. That is what this case is about.

The Company believes it has demonstrated that its request – as amended in its final schedules contained in its Rejoinder Filing – is reasonable and will provide CWCGV the ability to meet costs in the near future. The Company requests that the Commission issue a final order that: (1) approves increasing the revenue requirement by $803,315 for a total revenue requirement of $3,825,058; (2) a FVRB of $7,504,829; (3) approves a 15 percent operating margin that will give CWCGV a fair rate of return on FVRB; (4) does not include CIAC related to CWIP in the rate base determination; (5) approves the Company's proposed rate design and miscellaneous charges;

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[50] Tr. at 77.
[51] Staff Brief at 12-13.
[52] Tr. at 76, 80, 99.
[53] Tr. at 191.

(6) all Company-proposed adjustments as contained in its Final Schedules submitted in its Rejoinder Filing.

RESPECTFULLY SUBMITTED this 8th day of December, 2009.

By ______________________
Jason D. Gellman
ROSHKA DEWULF & PATTEN, PLC.
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

Original and thirteen copies of the foregoing filed this 8th day of December, 2009, with:

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered this 8th day of December, 2009, to:

Lyn A. Farmer, Esq.
Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Janice Alward, Esq.
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Steve Olea
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Arturo R. Gabaldon
President
Community Water Company of Green Valley
1501 South La Canada
Green Valley, AZ 85614-1600

Thomas J. Bourassa
139 W. Wood Drive
Phoenix, Arizona 85029

By Debbie Amaral